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DISSOLUTION, FORFEITURE, AND LIQUIDATION OF VIRGINIA CORPORATIONS

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INTRODUCTION

Article 7 of Virginia's Corporation Code,[1] under the general heading of "dissolution",[2] describes the various methods by which corporate existence terminates in Virginia. Although Article 7 speaks in terms of dissolution per se, in reality there are three separate and distinct forms of dissolution: (1) voluntary dissolution,[3] (2) forfeiture,[4] and (3) liquidation of the corporation by a court of equity upon the petition of either the stockholders or the creditors of the corporation sought to be dissolved.[5] Each section is sui generis and has certain procedures which incorporators, the State Corporation Commission (Commission), stockholders, or creditors must follow in order to dissolve the corporation of which they are a part or of which they have a public or private interest. The procedures for each provision raise legal issues which effect, either directly or indirectly, the rights and interests of the parties described above.

This article consists of five separate parts which not only analyze the three methods of dissolution previously mentioned but also detail the survival of remedies after dissolution[6] and lastly suggests legislative reform for selected provisions in an effort to streamline unnecessary provisions and to eliminate inequities in others. The

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1. VA. CODE ANN. §§ 13.1-79 to -101 (Repl. Vol. 1973 & Cum. Supp. 1977).

2. In its broadest sense dissolution of a corporation has been defined as "the termination of its corporate existence in any manner, whether by the expiration of the charter, decree of court, act of the Legislature . . ." New York Title & Mortgage Co. v. Friedman, 153 Misc. 697, 276 N.Y.S. 72, 74 (1934), a governmental decree, or the voluntary act of its members. "It becomes *civiliter mortuus.*" *Id.* Dissolution involves, implies, and contemplates the end of the corporate existence. *Id.*

3. VA. CODE ANN. §§ 13.1-79 to -81 (Cum. Supp. 1977).

4. VA. CODE ANN. §§ 13.1-91 & -93 (Cum. Supp. 1977). Sections 13.1-91 and 13.1-93 are entitled automatic and involuntary dissolution, respectively. However, as described in more detail in Section II *infra,* both dissolutions are in the nature of and are more properly called forfeitures.

5. VA. CODE ANN. § 13.1-94(a)-(b) (Repl. Vol. 1973).

6. VA. CODE ANN. § 13.1-101 (Repl. Vol. 1973).

analysis first outlines the mechanics of the section under discussion, identifies the legal issues associated with each provision, and then examines Virginia case law and relevant case law of other jurisdictions so that the problems and pitfalls presented by corporate dissolution may be understood and thereby avoided by both lawyer and layman alike.

I. VOLUNTARY DISSOLUTION

In Virginia, voluntary dissolution is a deliberate choice made by the stockholders or the incorporators of the corporation and can be performed in one of three ways: (1) by dissolving a corporation before it has commenced business and has issued stock,[7] (2) by written consent of all its stockholders,[8] or (3) by corporate resolution wherein more than two-thirds of the shares entitled to vote affirmatively decide to dissolve the corporation.[9]

Of the three methods described above, dissolving a corporation before it has commenced business *and* has issued stock is by far the easiest and yet the least used of all the voluntary dissolution provisions. Very few corporations can meet the statutory criteria of not having begun business and not having issued stock since for all intents and purposes a corporation, as it is commonly regarded, has not even come into existence at this point; in essence, Virginia has provided a procedure which permits individuals who have selected the corporate form in which to do business to change their minds before either creditors or stockholders have acquired any interest in the assets of the corporation. When a majority of the incorporators

7. VA. CODE ANN. § 13.1-79 (Cum. Supp. 1977).

8. VA. CODE ANN. § 13.1-80 (Cum. Supp. 1977).

9. VA. CODE ANN. § 13.1-81 (Cum. Supp. 1977). It should be noted at this point that a form of voluntary dissolution (perhaps more properly labelled passive dissolution) not discussed in this article is the dissolution of a corporation upon the expiration of its charter. Early in the history of corporations many companies, especially railroads, Rider v. Nelson & Albemarle Union Factory, 34 Va. (7 Leigh) 154 (1836), and mining operations, Mason v. Pewabic Mining Co., 133 U.S. 50 (1890), were chartered for a particular purpose and given a clearly expressed time limit within their charter to achieve this purpose. When this time limit expired, the corporation ipso facto dissolved without any direct action by the state. At this point the corporation had a limited existence for the purpose of winding up its affairs. Knights of Pythias v. Weller, 93 Va. 605, 25 S.E. 891 (1896). However, this issue seldom arises today since few corporations have pre-determined existences, and, in the absence of a specific period of duration, corporate existence is deemed to be perpetual.

execute a document entitled "articles of dissolution"[10] and deliver this document to the Commission, the Commission, after it finds that the articles of dissolution comply with the requirements of law and that all required fees have been paid, *shall* by order issue a certificate of dissolution.[11] Upon the issuance of a certificate of dissolution, the existence of a corporation comes to a complete end.[12]

Sections 13.1-80 and 13.1-81, respectively, set forth the requirements for voluntary dissolution by written consent of all stockholders and by affirmative vote of more than two-thirds of the shares of corporate stock entitled to vote for or against dissolution.[13] Unlike section 13.1-80 which does not require a formal meeting to discuss dissolution, section 13.1-81 requires the board of directors to adopt a resolution recommending dissolution and to give notice to each stockholder of record that a meeting will be held to consider the

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10. The statutory requirements for articles of dissolution are set forth in VA. CODE ANN. § 13.1-79(a)(1)-(6)(Cum. Supp. 1977). It should be mentioned that the articles of dissolution and the statement of intent to dissolve, which are mandated for voluntary dissolution under sections 13.1-80 and 13.1-81, are materially different. Indeed, the requirements for a statement of an intent to dissolve under the above-referenced sections differ between themselves. *Compare* § 13.1-80(a)-(d) *with* 13.1-81(d)(1)-(6).

11. The Virginia Supreme Court, in Jeffries v. Commonwealth, 121 Va. 425, 93 S.E. 701 (1917), held, *inter alia*, that once a corporation has complied with the statutory requirements for voluntary dissolution, the function of the Commission in issuing the certificate of dissolution is purely ministerial. The court explained:

> The form and wisdom of the method of voluntary surrender of corporate franchises are matters which were expressly delegated to the legislature by the terms of the Constitution, and as to them neither the Corporation Commission nor this court can have any controlling voice.

121 Va. at 431, 93 S.E. at 702.

12. It would appear that the provisions of section 13.1-101 which provide for the survival of remedies after dissolution, i.e., empowering a corporation to sue or be sued after dissolution, are inapplicable in the context of a section 13.1-79 dissolution since, if a corporation has not commenced business and has not issued stock, it is doubtful whether any rights or interests of creditors or stockholders have come into existence thereby precluding a cause of action from arising.

13. In sustaining the constitutionality of an earlier statute similar to section 13.1-81 (*see* Michie's Va. Code 1942 § 3820(a)), the Virginia Supreme Court in Craddock-Terry Co. v. Powell, 181 Va. 417, 25 S.E.2d 363 (1943) held, *inter alia*, "the sales statute . . . is not violative of any constitutional inhibition (sec. 158); that is, the legislature has power to authorize a corporation to sell all of its assets for cash or securities with the consent of two-thirds of the stockholders of each class of stock." *Id.* at 434, 25 S.E.2d at 369-70. If a two-thirds majority authorizing dissolution is constitutionally permissible, then presumably the unanimous written consent of stockholders pursuant to section 13.1-80 would meet constitutional muster as well.

advisability of dissolving the corporation.[14] However, even though the required vote opting for dissolution is attained, some jurisdictions, under certain circumstances, will set aside the corporate resolution favoring dissolution.

The North Carolina Supreme Court in *White* v. *Kincaid,*[15] described the fiduciary duty in the area of voluntary dissolution by analogy to the fiduciary duty owed by majority stockholders to minority stockholders in dictating the actions of corporate directors in such matters as the assignment or disposition of corporate assets.

> In these cases, also, if it clearly appears that the action of the management is in bad faith; that the resolution for dissolution, for instance, has been superinduced by fraud or undue influence, or if it could be clearly established that this resolution was not taken for the benefit of the corporation, or in furtherance of its interest, but for the mere purpose of unjustly oppressing the minority of the stockholders, or any of them, and causing a destruction or sacrifice of their pecuniary interests or holdings, giving clear indication of a breach of trust—such action could well become the subject of judicial scrutiny and control.[16]

The court in *White* then cited specific examples which evince a prima facie breach of the fiduciary duty of the persons in charge of the corporation:

> Such cases almost invariably arise when the management of a solvent concern, going and prosperous, ceases operations and determines to dissolve and sell out, with a view of continuing the same or similar business under different control, and when there is indication given that the sole purpose was to oppress some of the stockholders and confiscate their holdings, or when it is done in furtherance of some scheme to promote the pecuniary interest of the actors, and to the detriment of the corporation, giving indication of a breach of trust on the part of the authorities in charge and control of the corporate affairs.[17]

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14. VA. CODE ANN. § 13.1-81(a)-(b) (Repl. Vol. 1973).
15. 149 N.C. 415, 63 S.E. 109 (1908).
16. 63 S.E. at 111 (citations omitted).
17. *Id.*

Although a situation where majority stockholders have sought to dissolve a corporation prompted by the factors described above has not arisen to date in Virginia,[18] courts here should follow the lead of the court in *White* where it appears that majority stockholders, in seeking dissolution, have violated their fiduciary obligations to other stockholders.

Excluding exceptional circumstances amounting to a breach of fiduciary duty, section 13.1-82 requires the statement of intent to dissolve, whether submitted pursuant to the unanimous consent of the stockholders or pursuant to a resolution of the board of directors, to be delivered to the Commission which will, after it determines whether the statement complies with the requirements of law and when the necessary franchise taxes and fees have been paid by the corporation, file the statement in its office. However, it is important to note that the ministerial function of the Commission is inapplicable to statements of intent to dissolve filed by public service corporations. Section 13.1-82 specifically mandates that the Commission not file the statement of intent to dissolve of a public service corporation, "unless it finds that the corporation is not actually performing any public service, or should not be required to continue to perform any public service, or that public convenience and necessity do not require that it continue to perform any public service."[19] This provision appears to overrule that part of *Jeffries v. Commonwealth*,[20] which stands for the proposition that public service corporations may voluntarily dissolve, just as their private counterparts do, without the approval of the Commission.[21]

18. This set of facts should not be confused with an action by minority stockholders seeking judicial liquidation of the assets and business of a corporation in a court of equity pursuant to section 13.1-94(a)(1)-(4), discussed in Section III *infra*.

19. VA. CODE ANN. § 13.1-82 (Repl. Vol. 1973).

20. 121 Va. 425, 93 S.E. 701 (1917).

21. The court in *Jeffries* offered the following rationale for its decision:

> That inconvenience and hardship may and probably will result when railroads and other public utilities cease operations is undeniably true; but the same thing is just as likely to be true, in greater or less degree according to the character and extent of the corporate enterprise, of the dissolution of purely private corporations, concerning which no question is made as to their right to dissolve without notice.

121 Va. at 444, 93 S.E. at 707.

This line of reasoning is somewhat persuasive; however, considering the reliance of the general public upon public service corporations for energy and transportation needs, the public interest should require that dissolution of public service corporations be given close

After a corporation has filed its statement of intent to dissolve with the Commission, it must thereupon do two things: (1) it must immediately mail notice of impending dissolution to each known creditor,[22] and (2) it must cease doing business, except insofar as may be necessary for the winding up thereof.[23] Although neither section 13.1-83 nor section 13.1-84 specifically states what is meant by winding up the affairs of a corporation, section 13.1-84(b) describes in precise terms what a corporation is required to do to wind up its affairs properly. A corporation must:

> collect its assets, sell, convey and dispose of such of its properties as are not to be distributed in kind to its stockholders, pay, satisfy and discharge its liabilities and obligations and do all other acts required to liquidate its business and affairs, and, after paying or adequately providing for the payment of all its obligations, distribute the remainder of its assets, either in cash or in kind, among its stockholders according to their respective rights and interests.[24]

While the above-mentioned provision specifies *what* should be done upon voluntary dissolution, it fails to indicate *how* it should be done. As illustrative of a judicially approved method to meet the statutory requirements of section 13.1-84(b) for winding up a corporation, the Fourth Circuit Court of Appeals in *Tazewell Electric Light & Power Company* v. *Strother*[25] permitted the majority of stockholders to appoint a liquidating trustee to administer the voluntary dissolution of the corporation since the appointment was not expressly prohibited by the statute.

Once a corporation has decided upon voluntary dissolution, it

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scrutiny by the Commission lest the vital services provided by these corporations be curtailed or eliminated entirely.

22. VA. CODE ANN. § 13.1-84(a) (Repl. Vol. 1973).

23. VA. CODE ANN. § 13.1-83 (Repl. Vol. 1973).

24. VA. CODE ANN. § 13.1-84(b) (Repl. Vol. 1973).

25. 84 F.2d 327 (4th Cir. 1936). This case construed former section 3810 of the 1930 Code of Virginia which called for, among other things, the winding up of corporate affairs without explaining how. While the Corporation Code of Virginia has undergone substantial amendments since the *Tazewell* decision (especially the revisions made in 1956), these amendments have not specified or clarified how a corporation should wind up its affairs and presumably the method approved in 1936 is still acceptable.

Former section 3810 has been replaced by section 13.1-101 which provides for the survival of remedy after corporate dissolution.

does have an opportunity, if done before the Commission issues a certificate of dissolution, to effectively rescind its statement of intent to dissolve.[26] Essentially, the provisions in question require the corporation to do the exact opposite of what it did in obtaining its statement of intent to dissolve, viz.: unanimous written consent is required to revoke a dissolution pursuant to section 13.1-80 or the board of directors of a corporation must adopt a resolution recommending that voluntary dissolution proceedings be revoked, send notice of a meeting for the above purpose to each stockholder of record, hold said meeting, and obtain the required approval of more than two-thirds of the shares eligible to vote on the issue. After the filing of the statement of revocation of voluntary dissolution proceedings with the Commission and if the statement complies with the requirements of law and all required fees and franchise taxes have been paid, the Commission shall issue a certificate of reinstatement.[27] "Upon the issuance by the Commission of a certificate of reinstatement the dissolution proceedings shall be revoked and the corporation may again carry on its business."[28] Assuming, however, that a corporation has determined to dissolve voluntarily under either section 13.1-80 or section 13.1-81, has filed the requisite statement of intent to dissolve, and has proceeded to wind up its affairs in accordance with section 13.1-84(b), an important question arises: What is the status of the corporation from the time it begins to wind up its affairs until the Commission issues a certificate of dissolution under section 13.1-90 which officially terminates a corporation's existence?[29] Section 13.1-83 provides in relevant part that

26. Section 13.1-85 specifies the requirements to revoke a voluntary dissolution by unanimous written consent of the stockholders under section 13.1-80; section 13.1-86 states the requirements to revoke voluntary dissolutions by more than two-thirds of the stockholders eligible to vote thereon under section 13.1-81. For federal income tax purposes, however, "[t]he voluntary dissolution of a corporation . . . is such a definitive and irrevocable act done under the hand and seal of the Virginia State Corporation Commission that there is no room for a subsequent denial or alteration of the fact." Shull v. Commissioner, 291 F.2d 680, 682 (4th Cir. 1961). The above-quoted passage, however, would appear to apply to a corporation whose voluntary dissolution papers have been *approved* by the Commission and not to a corporation which is seeking to revoke the voluntary dissolution proceedings it instituted under either section 13.1-85 or section 13.1-86.

27. VA. CODE ANN. § 13.1-87 (Repl. Vol. 1973).

28. VA. CODE ANN. § 13.1-88 (Repl. Vol. 1973).

29. An intermediate step in the final voluntary dissolution of a corporation requires the corporation, pursuant to section 13.1-89, to file articles of dissolution with the Commission

"its corporate existence shall continue until a certificate of dissolution has been issued by the Commission."[30] At this point, barring any activities on the part of the corporation to continue its business in its customary manner, the corporation has a *qualified* existence for the sole purpose of winding up its affairs; it is neither a de facto corporation which would require "a law under which the corporation might be organized . . ." and that "corporate powers have been thereafter exercised,"[31] nor is it a de jure corporation under which corporate existence no longer exists as a matter of law.

It is conceivable to envision a situation where, in the process of winding up, a corporation may decide, for whatever reason, to resume business. In this instance the corporation would have a de facto existence, but unlike an automatic or involuntary dissolution,[32] which calls for corporate and/or *individual* liability for contracts made or torts committed during this period, only *corporate* liability would attach since nowhere in the voluntary dissolution provisions is there any mention of individual liability for actions performed during the winding-up phase. Given sections 13.1-85 and 13.1-86 by which a corporation can rescind its decision to dissolve voluntarily and be reinstated with full corporate powers, a corporation, however, can easily avoid the predicament described above by filing the appropriate papers seeking reinstatement.

Even though a corporation's existence legally ends once its articles of dissolution have been approved by the Commission and the required order is entered, it should be noted: "Upon the issuance of

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after " 'all assets of the corporation have been distributed to its creditors and stockholders' [which] means that the corporation has divested itself of all its assets by the payment of claims or liquidating dividends or by assignment to a trustee or trustees for the benefit of claimants or stockholders." VA. CODE ANN. § 13.1-89 (Cum. Supp. 1977). In addition to the foregoing, the corporation is required to "file a certificate signed by the State Tax Commissioner that the corporation has filed a return and has paid all State taxes on account of its income to the time of the certificate." *Id.* Again, if the Commission finds that the corporation has complied with the requirements of law and has paid its fees and taxes, it shall by order issue a certificate of dissolution.

30. VA. CODE ANN. § 13.1-83 (Repl. Vol. 1973).

31. Von Longerke v. City of N.Y., 150 App. Div. 98, 134 N.Y.S. 832, 836 (1912), followed in Wilson v. Brown, 107 Misc. 167, 175 N.Y.S. 688, 691 (1919). Theoretically, a corporation existing under section 13.1-83 would be de facto; however, if it is totally committed to liquidating its assets and making the appropriate distributions, it would not be exercising its corporate powers and therefore would not be a de facto corporation.

32. *See* Section II *infra*.

such certificate of dissolution the existence of the corporation shall cease, *except for the purpose of suits, other proceedings and appropriate corporate action by stockholders, directors and officers as provided in this Act*."[33] This is a direct reference to section 13.1-101, which provides for the survival of remedies after dissolution for any right or claim existing or any liability incurred prior to dissolution. A discussion of section 13.1-101 and its effects on the rights and interests of all parties concerned follows in Part IV.

II. AUTOMATIC AND INVOLUNTARY DISSOLUTION

Virginia provides for the *automatic* dissolution of a corporation when it fails to file annual reports or to pay the annual registration fee or franchise tax for two successive annual dates as required by law[34] and requires *involuntary* dissolution whenever a corporation exceeds or abuses the authority conferred upon it by law, fails to maintain a registered office or a registered agent within the state as required by law, or fails to comply with any act required by the Commission pursuant to 13.1-133.[35] In reality, the term "dissolu-

33. VA. CODE ANN. § 13.1-90 (Repl. Vol. 1973) (emphasis added).

34. VA. CODE ANN. § 13.1-91 (Cum. Supp. 1977). The instant statute traces its origin to a constitutional provision adopted in 1902 which subsequently became incorporated into a tax law in 1903 and was later amended in 1906. This sequence of events was explained by the Virginia Supreme Court in Elliot's Knob Iron, Steel & Coal Co. v. State Corp. Comm., 123 Va. 63, 96 S.E. 353 (1918):

> By section 157 of the Constitution of Virginia of 1902, a constitutional provision was adopted which was not contained in the state Constitution theretofore existing, and which, so far as material in the instant case, is as follows:
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> . . . .
>
> . . . *The failure* by any corporation *for two successive years to pay its annual registration fee, or to make its said annual reports,* shall, *when such failure shall have continued for ninety days after the expiration of such two years, operate as a revocation and annulment of the charter* of such corporation . . . .

123 Va. at 66-67, 96 S.E. at 353-54. Then after repeating an almost identical provision, as the one cited above, which appeared in a tax bill which became law on April 16, 1903, the court further stated:

> The tax bill which became a law March 17, 1906, amended the last three paragraphs of section 41 of the tax bill of 1903 . . . so that the whole of such statute (so far as material) read [*sic*] as follows:
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> . . . .
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> "The failure of any corporation for two successive years to pay its annual registration fee, or to make such report, shall, when such failure shall have continued for ninety days after the expiration of such two years, operate, *without further proceedings*, as a revocation and annulment of the charter of such corporation . . . ."

123 Va. at 69-70, 96 S.E. at 354.

35. VA. CODE ANN. § 13.1-93 (Cum. Supp. 1977).

tion" used in the statutes under discussion is a legal misnomer and should more properly be termed a "forfeiture" of a corporation's charter for failure to perform certain acts by a certain time as mandated by the State in its compact with the corporation. Fletcher, in his treatise on corporate law, states the general rule regarding the effect a forfeiture has on corporate existence in circumstances analogous to automatic dissolution under section 13.1-91:[36]

> Failure of a corporation to make reports or to pay franchise taxes or fees as required by statute, although good ground for forfeiture of the company's charter, does not, of itself, work a dissolution but at most causes a suspension of some or all of the company's powers.[37]

However, as an exception to the general rule quoted above, Fletcher notes:

> Whether or not such forfeiture results ipso facto from the corporation's failure to make the required report or to pay the prescribed taxes or fees must, of course, depend upon the terms of the particular statute. It is undoubtedly within the power of a state legislature to declare that a corporation thus delinquent shall ipso facto cease to exist, and enactments of that character have been passed and upheld as constitutional.[38]

In a footnote to the passage quoted above, Fletcher lists Virginia as one of five jurisdictions in which failure to file annual reports or to pay annual franchise taxes results in an ipso facto forfeiture of a

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36. 16A FLETCHER, CYCLOPEDIA CORPORATIONS (Rev. Vol. 1962) [hereinafter cited as FLETCHER]. Presumably Fletcher's analysis would equally apply to omissions of a corporation under the involuntary dissolution provisions of section 13.1-93 since for all intents and purposes there is no appreciable difference in the prejudice visited upon the state or the public for failing to perform any of the requirements identified in either statute.

The importance of filing annual reports is best stated in People v. Buffalo Stone & Cement Co., 131 N.Y. 140, 29 N.E. 947, 948-49 (1892):

> The duty is not simply one in which particular persons are alone interested, but it is a duty which the corporation owes to the public generally for the protection of all persons who may have occasion to deal with it, and to subserve a plainly expressed public policy; and for the omission to perform the duty it incurs the liability of forfeiture of its charter.

37. FLETCHER, *supra* note 36, at § 7997.

38. *Id.* (footnote omitted).

corporate charter. The apparent rationale for Fletcher's conclusion regarding Virginia stems from the Virginia Supreme Court's decision in *Fidelity & Casualty Company of New York v. Lackland,*[39] where the directors and trustees of the James River Concrete Pipe & Products Corporation, which had forfeited its corporate charter as of May 31, 1937, for failure to pay the registration fee and franchise tax assessed against it for two preceding years, instituted suit against a surety company. Under section 3812 of the Virginia Code, a forerunner statute to section 13.1-91,[40] a corporation which had dissolved, expired, or whose charter had been revoked by operation of law, could, through its directors, who became trustees of the corporation, settle the outstanding affairs of the corporation, i.e., file suit. The surety company raised the defense that revocation of the charter of a corporation for its failure to pay its registration fee and franchise tax did not work a "dissolution" of a corporation within the meaning of section 3812 of the Code and therefore the plaintiffs had no right to file suit. The court rejected defendant's contention and stated:

> We think it is too plain for argument that the "revocation and annulment of the charter" of this corporation for the failure to pay its taxes, was a "dissolution, expiration or revocation *by operation of law*" of the corporation within the meaning of section 3812 . . . .[41]

Virginia's unique automatic dissolution provision which works a forfeiture of a corporate charter *by operation of law* has the legal effect of causing a de jure dissolution as opposed to a de facto dissolution.[42]

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39. 175 Va. 178, 8 S.E.2d 306 (1940).

40. The relevant portion of section 13.1-91 states in pertinent part:

> [T]he trustees shall proceed to collect the assets of the corporations, sell, convey and dispose of such of its properties as are not to be distributed in kind to its stockholders, pay, satisfy and discharge its liabilities and obligations and do all other acts required to liquidate its business and affairs, and, after paying or adequately providing for the payment of all its obligations, distribute the remainder of its assets, either in cash or in kind, among its stockholders according to their respective rights and interests.

41. 175 Va. at 191, 8 S.E.2d at 311 (emphasis added).

42. An explanation of a de facto and de jure corporate dissolution is provided in 8 CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING (1977):

> The dissolution of any corporate entity may either be "de facto" or "de jure." A de facto dissolution occurs when a corporation terminates its business either because of

Although the corporation is legally dead in a de jure dissolution, some semblance of corporate activity remains as upon dissolution under section 13.1-91 because the corporation's "properties and affairs shall pass automatically to its directors as trustees in dissolution"[43] and they are instructed under the statute to wind up the corporate affairs.[44] All too often, however, whether because the

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> insolvency, the loss of all its assets or some similar reason, disabling in nature. However, at no time does the corporation lose its mandate and legal status to act as a corporation. On the other hand, a de jure dissolution takes place when that legal mandate to act as a corporation either has been removed by court decree or no longer exists as a matter of law. The latter situation may occur upon the happening of a condition subsequent, i.e., the period of incorporation having expired, or through forfeiture. Although the corporation may continue in either instance to have the physical capability of doing business, it is still considered *legally* "dead" upon dissolution. As a result, the corporation loses its franchise, which had been granted to it by the state, to conduct its affairs as a corporation.

Id. at § 185.02(3)(footnotes omitted).

43. VA. CODE ANN. § 13.1-91 (Cum. Supp. 1977).

44. *See* note 42 *supra*.

Nowhere in the statutes under consideration is there an explanation of *how* the trustees should proceed to wind up the affairs of a corporation. By way of explanation to aid the Virginia practitioner in this regard, the following language taken from Hogsett v. Dallas Mortgage Sec. Co., 110 S.W.2d 135 (Tex. Civ. App. 1937), is offered as a logical and appropriate method for corporate officials to wind up the affairs of a corporation dissolved under any of the Virginia dissolution provisions. The passage states the rationale for making the directors trustees of the corporation, describes how they should act to dissolve the corporation, and analyzes *why* they should act in the prescribed manner.

> The reason for entrusting to the president and directors of a dissolved corporation the business of winding up its affairs, obviously, was because of their familiarity with and interests in its affairs. This could not be said of any stranger selected to fill a vacancy on the board. Construing similar provisions of a statute and speaking of the legislative reason for devolving these administrative duties upon existing corporate officers, the Supreme Court, in Witherspoon v. Texas Pacific R.R. Co., supra, 48 Tex. 309 at page 319, said: "The statute, in thus providing for the settlement of the affairs of sold-out railroad companies, was enacted on the supposition that the existing directory were more familiar with the business of the company, and, if not superseded by legislative or judicial action, could more readily and satisfactorily wind up and adjust their unsettled business than any other parties. They are designated trustees, because, in discharge of the duties imposed upon them, they do not act under authority of the franchise and charter of the company, but merely as the representatives of its stockholders and creditors . . . . The language of the statute plainly indicates that the power conferred upon them as trustees *is to be exercised collectively, and in their aggregate capacity as a body, and not as individuals.* To give to each of the directors distinct and independent power to wind up and settle the business of the company, would evidently lead to confusion and conflict of action, which would be injurious to the interest of the parties for whose benefit they are made trustees; nor would it be consistent with reason or justice that the trustees should be made jointly and severally

Commission's notice of impending dissolution never reaches the corporate offices, or because of negligent or willful disregard of the requirements in question, the corporate directors or officers do not wind up the affairs of the corporation but instead continue to operate the corporation as if it still existed as a legally viable entity. In such a situation the critical issue becomes who is liable to third persons for contracts made or for torts committed during the period described above. On this precise question there are no Virginia decisions on point;[45] in other jurisdictions where this problem has emerged the holding of the court was necessarily controlled by the statute under consideration.

Nonetheless, certain theories have developed from these cases which provide helpful guidance in interpreting section 13.1-91. In general, the weight of authority appears to find the corporation *itself* liable to third parties in actions ex contractu or ex delicto under a de facto dissolution analysis rather than on a de jure dissolution theory. Finding corporate liability instead of individual liability is bottomed upon interpreting that particular jurisdiction's statute as providing for some limited form of corporate existence, the possibility of reinstatement, or actual reinstatement which fully revives a

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> responsible for property coming into their hands, unless it came to them in their collective capacity."

110 S.W.2d at 139 (emphasis added)(citations omitted).

45. In a bankruptcy proceeding in In re Booth's Drug Store, Inc., 19 F. Supp. 95 (W.D. Va. 1937), the court, in analyzing former section 3810 of the Code of Virginia which, although more akin to § 13.1-101, nevertheless is similar enough for discussion of this question, held, *inter alia*, the *individuals* of a corporation liable for a promissory note when they continued the business of the corporation instead of winding up the corporate affairs after their charter had been forfeited for failure to pay their annual registration fee and franchise taxes for two consecutive years. The court observed:

> The statute specifically grants to a dissolved corporation the power to convey and dispose of its property. For that purpose and to that extent it is still a living entity. The powers of the corporation are limited after its dissolution but if, acting within the limits of those powers, it commits an act of bankruptcy, there would seem no reason why it should be immune from the legal consequences of such act.

Id. at 97.

The court posited the following reasoning for its holding:

> To hold otherwise would be to open a rather wide door to fraud and would bar the bankruptcy courts from taking jurisdiction in a class of cases which would rapidly increase if such bar was established. Corporations which were dissolved would, in winding up their affairs, be practically without restriction as to preferences to creditors, either by voluntary transfer of property or by legal proceedings.

Id.

corporation's existence.[46] Other courts have failed to hold individuals personally responsible either under the guise of familiar legal principles, such as the contractual concept of "the intent of the contracting parties,"[47] or upon equitable considerations.[48] However, given the fact that under section 13.1-91 an automatic dissolution works a forfeiture of the corporate charter *by operation of law* thereby stripping the corporation's legal mandate to exist, there is no corporation at all, and any action performed by the directors or officers not looking to the dissolution of the corporation should be deemed *individual* actions with concomitant individual liability therefor.[49]

Illustrative of the cases which have found individual liability[50] for debts (as a result of contracts entered into after forfeiture of the corporation's charter) is *In re Hare,*[51] which found a husband and wife jointly liable as partners to petitioning creditors in bankruptcy. The court explained:

> Persons who continue business operations and incur debts in the name of a forfeited corporation, after forfeiture and prior to revival, are individually liable for such debts. . . . "Under certain circumstances, stockholders, officers and directors may be held liable as individuals or partners when such stockholders, officers and directors

46. Watts v. Liberty Royalties Corp., 106 F.2d 941 (10th Cir. 1939). *See generally* 19 Am. Jur. 2d. *Corporations* §§ 1646-52 (1965) and Annot., 13 A.L.R.2d 1220 (1950).

47. Held v. Crosthwaite, 260 F. 613 (2nd Cir. 1919). The common understanding of both parties was that a corporation and not a sole proprietorship existed. The court reasoned: "The plaintiff acted upon the supposition that he was dealing with the defendants, not individually, but as representing the Crosthwaite & Cannon Company, and the defendants acted upon the same understanding." *Id.* at 617.

48. Deutsch v. Aaron & Lillie Straus Foundation, Inc., 155 F. Supp. 551, 552 (D. Md. 1957).

The Court refused to find a ninety-year-old, blind benefactor of a summer camp individually liable for injuries sustained by a minor at the camp.

49. Research has not encountered a situation where it was disputed whether the activities performed by the trustees were in the nature of winding up the business or in continuing the business. Under such circumstances it would appear that the activities of the trustees should be carefully scrutinized to determine whether they fall within the winding up of corporate affairs under the statute.

50. *See, e.g.,* Poritzky v. Wachtel, 176 Misc. 633, 27 N.Y.S.2d 316 (1941); Bulova Watch Co. v. Roberts Jewelers, 240 S.C. 280, 125 S.E.2d 643 (1962); First Nat'l Bank v. Silberstein, 398 S.W.2d 914 (Tex. 1966); Sheffield v. Nobles, 378 S.W.2d 391 (Tex. Civ. App. 1964).

51. 205 F. Supp. 881 (D. Md. 1962).

permit the charter of a corporation to expire, and continue to obtain credit for or on behalf of a purported but non-existent corporation."[52]

The court observed further:

> While there are cases to the effect that forfeited corporations, organized under state law which gives a right of revival, may for some purposes be treated as corporations, . . . this doctrine has been primarily invoked where it is necessary to protect the rights of third persons. . . . The doctrine is clearly inapplicable here, because the petitioning creditors do not seek relief against Hare Bros., Inc. and where by Maryland law, the forfeited corporation is deemed nonexistent, and where its operations have been continued for seven and a half years without revival, in clear violation of the Maryland statute, it would be unconscionable to permit the alleged bankrupts the defense that the corporation continues to enjoy a *de facto* status and insulates them from personal liability.[53]

As with a corporation which seeks to revoke voluntary dissolution proceedings by following the procedures set forth in either section 13.1-85 or section 13.1-86, a corporation which is automatically dissolved may, within five years after its charter has been forfeited, seek reinstatement under section 13.1-92. A typical case in which a corporation would seek reinstatement is when an action is brought against it after its charter has been automatically or involuntarily dissolved and the directors, officers or shareholders learn the corporation's legal status and try to protect themselves from individual

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52. *Id.* at 883 (citations omitted).

53. *Id.* at 883-84 (citations omitted).

Likewise, courts have found personal liability in tort actions for individuals who have continued the operation of the corporation despite its legal nonexistence. In *Seavy v. I.X.L. Laundry*, 60 Nev. 324, 108 P.2d 853, 856 (1941), in which a business invitee was injured while on the defendant's premises, the court stated:

> A corporation or those representing it have been held liable after dissolution for torts committed prior to dissolution, where the statute continued the existence of the corporation for the purpose of settling and winding up its affairs.
>
> . . . .
>
> Where the business of a corporation, old and new, is continued as usual, and is not limited to settling the affairs of the corporation, then the stockholders become personally liable.

See, e.g., Jones v. Young, 115 W.Va. 225, 174 S.E. 885 (1934), which held the stockholder, who continued the business of a corporation after forfeiture of its charter for non-payment of license taxes, personally liable for the electrocution of an employee caused by the negligence of management.

liability. The key sentence of the reinstatement provision states in pertinent part:

> Upon the entry by the Commission of an order of reinstatement, *the corporate existence shall be deemed to have continued from the date of dissolution except that reinstatement shall have no effect on any question of personal liability of the directors, officers, or agents in respect of the period between dissolution and reinstatement.*[54]

With the above-quoted sentence in mind, an important issue is what liability, if any, attaches for the acts of directors, officers, or stockholders performed in the interim period between dissolution and reinstatement. One commentator provides a succinct answer:

> A handful of statutes expressly make the revival of corporate existence retroactive. Thus its revival becomes effective as of the date on which the corporation was dissolved and any acts performed by the corporation in the interim are valid.[55]

In a footnote immediately following the above-cited statement, Cavitch suggests, with particular regard to Virginia Code section 13.1-92:

> The provision appears to say that, in addition to full retroactive effect, the corporate directors, officers, and agents will also be personally liable, thus giving corporate creditors double security.[56]

From the above-cited analysis of section 13.1-92, it appears that two things happen when a Virginia corporation automatically dissolves and then is subsequently reinstated: (1) acts performed in the interim period between dissolution and reinstatement are deemed valid, which precludes either the corporation or its directors from defending lawsuits on the basis that their actions were void *ab initio*, and (2) individual directors, officers, or agents can be held personally liable for actions they take which go beyond winding up the affairs of a corporation.[57] It is submitted that a party

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54. VA. CODE ANN. § 13.1-92 (Cum. Supp. 1977) (emphasis added).

55. 8 CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING, § 187.02 (1977)(footnotes omitted).

56. *Id.* at n. 8.

57. *See* note 56 *supra*.

aggrieved by actions performed by either the corporation and/or its trustees during the time between dissolution and reinstatement use the "double security" theory posited by Cavitch to first seek to hold the corporation liable (since under the express terms of section 13.1-92 a corporation upon reinstatement is deemed to have continuously existed during the period in question) and then secondly, seek to hold the individual trustees liable (since reinstatement has no effect upon the liability the trustees incurred while the corporation had dissolved de jure). However, the above contention should not prevent a court from holding the trustees liable in the first instance when it is established that the trustees *knew* the corporate charter had been forfeited and still intentionally continued business without any attempt to wind up the affairs of the corporation, or where the court suspects fraud in the corporation's subsequent request for reinstatement. As observed by the court in *Poritzky v. Wachtel:*[58]

> To approve the application of the statute which the defendant urges would encourage fraud and abuse. Under such a construction, a former officer of a dissolved corporation could obtain credit and then upon subsequent discovery of the non-existence of the corporation, by merely paying arrears in franchise taxes, could shift the personal liability which the law would otherwise impose upon him back to the corporation.[59]

Accordingly, in those instances where the trustees willfully and knowingly continue to operate a corporation despite a legal mandate not to do so and where such activities smack of fraud, courts should impose individual liability on the trustees.

Under section 13.1-93 a corporation may be involuntarily dissolved for failure to perform certain duties more fully described at the beginning of this section. Section 13.1-93 is almost a carbon copy of the automatic dissolution provision, but instead of having a separate reinstatement provision (as section 13.1-92), the identical language found in section 13.1-92 is incorporated verbatim into the third paragraph of section 13.1-93. Hence, the analysis describing the effect on individual liability both before and after reinstatement

58. 176 Misc. 633, 27 N.Y.S.2d 316 (1941).
59. 27 N.Y.S.2d at 318.

applies as well to section 13.1-93. However, one important feature not found in section 13.1-91 is contained in the second paragraph of section 13.1-93 and states in its entirety:

> Before entering any such order [involuntarily dissolving a corporation] the Commission shall issue a rule against the corporation giving it an opportunity to be heard and show cause why such an order should not be entered. The Commission may issue the rule on its own motion or on motion of the Attorney General.[60]

It appears from the foregoing that unlike an automatic dissolution situation, a corporation which "involuntarily" dissolves has an opportunity to explain its actions (or omissions) and possibly prevent its charter from being forfeited by the state. Moreover, it would appear that the type of notice given a corporation in the case of an involuntary dissolution is more formal as compared with that in an automatic dissolution proceeding.[61]

III. JUDICIAL LIQUIDATION

Under section 13.1-94 in an action brought by a stockholder[62] or by a creditor,[63] "[a]ny court of record, with general equity jurisdiction in the city or county where the registered office or principal office of a corporation is located, shall have full power to liquidate the assets and business of the corporation. . . ."[64] If the action is instituted by a stockholder,[65] *one* of four conditions must be established before the court will liquidate the assets and business of a corporation:

> (1) That the directors are deadlocked in the management of the

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60. VA. CODE ANN. § 13.1-93 (Cum. Supp. 1977).

61. Under section 13.1-91 the Commission is only required to "mail notice to [the corporation] of impending dissolution."

A more detailed comparison of section 13.1-91 and section 13.1-93 and methods to eliminate any inequities between the two sections follows in Section V *infra* under the heading of Legislative Reform.

62. VA. CODE ANN. § 13.1-94(a) (Repl. Vol. 1973).

63. VA. CODE ANN. § 13.1-94(b) (Repl. Vol. 1973).

64. VA. CODE ANN. § 13.1-94 (Repl. Vol. 1973).

65. Research of the statute and applicable case law indicates no minimum stock holdings are required before suit is brought. Theoretically, a stockholder with one share of stock could file an action under the provision in question.

> corporate affairs and the stockholders are unable to break the deadlock, and that irreparable injury to the corporation is being suffered or is threatened by reason thereof; or
> (2) That the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent; or
> (3) That as shown by the proceedings at any meeting of the stockholders the stockholders are deadlocked in voting power and that irreparable injury to the corporation is being suffered or is threatened by reason thereof; or
> (4) That the corporate assets are being misapplied or wasted.[66]

Likewise, a creditor of a corporation can file suit under section 13.1-94(b) and force a liquidation of the assets and business of a corporation if the creditor establishes *one* of the following:

> (1) When the claim of the creditor has been reduced to judgment and an execution thereon returned unsatisfied and it is established that the corporation is insolvent; or
> (2) When the corporation has admitted in writing that the claim of the creditor is due and owing and it is established that the corporation is insolvent.[67]

In addition, the court has the power under section 13.1-94 to appoint a custodian(s) where it determines that the best interest of both the creditors and stockholders would be served. The custodian has the authority to continue the business of the corporation, to take all such actions as might be taken by the board of directors and to declare dividends.[68] The power of the custodian, however, does not continue indefinitely but ceases when the court determines that (1) to restore the management of the corporation to its board of directors would be in the best interest of its stockholders and the creditors, and (2) in the case where the board of directors were previously deadlocked in the management of corporate affairs or in its election, a new board has been duly elected.[69]

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66. VA. CODE ANN. § 13.1-94(a)(1)(4) (Repl. Vol. 1973).
67. VA. CODE ANN. § 13.1-94(b)(1)-(2) (Repl. Vol. 1973).
68. VA. CODE ANN. § 13.1-94 (Repl. Vol. 1973).
69. *Id.* In this regard, see Brennan v. Rollman, 151 Va. 715, 145 S.E. 260 (1928), where the court held that the chancellor properly refused to dissolve a corporation in a suit brought by minority stockholders and ordered the corporation turned over to its directors and stockholders. After appointment of receivers for the otherwise solvent corporation because of gross

It was established early in the development of corporate law that courts of equity had the power, upon suit filed by stockholders, to liquidate a solvent corporation. Contrary to the trend of decisions in Virginia today, however, the courts in earlier cases exercised their power with great circumspection which usually resulted in sustaining the corporation's existence from the challenge of minority stockholders.[70]

Recent decisions by the Supreme Court of Virginia indicate a trend away from upholding majority stockholder actions in operating the corporation to the detriment of minority shareholders. Moreover, recent decisions have gone so far as to state that section 13.1-94 is remedial in purpose and should be liberally construed.[71] In *White and P & W Oil Company v. Perkins,*[72] the leading case in this area, the court ordered the dissolution of a corporation when it became clear that the owner of fifty-five percent of the outstanding shares of the corporation was oppressing the minority shareholder,

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mismanagement and criminal recklessness of those persons in control, a new board of directors was elected by an overwhelming majority of stockholders, who were opposed to dissolution, and the persons who were responsible for the mismanagement and fraud were entirely eliminated.

70. *See, e.g.,* South Norfolk Land Co. v. Tebault, 124 Va. 667, 98 S.E. 679 (1919); Radford West End Land Co. v. Cowan, 101 Va. 632, 44 S.E. 753 (1903); and later cases, such as, Louis Adelman Assoc. v. Goldsten, 209 Va. 731, 167 S.E.2d 104 (1969); Penn v. Pemberton & Penn, Inc., 189 Va. 649, 53 S.E.2d 823 (1949). *But cf,* Gudebrod v. Ward's Adm'r, 165 Va. 444, 182 S.E. 118 (1935).

As the Virginia Supreme Court in Brennan v. Rollman, 151 Va. 715, 145 S.E. 260 (1928) explained:

> The power of courts of equity to take possession of, and liquidate a functioning solvent corporation at the instance of minority stockholders, is recognized in many jurisdictions, including Virginia. But, while the . . . authorities establish the power of the courts to dissolve corporations, *it is concededly a power that can be easily abused, and one that should be cautiously exercised.* If the purposes for which the company was formed have become impossible of attainment, and to continue the business would be manifestly ruinous to its shareholders, equity may interpose but not otherwise.

Id. at 731, 145 S.E. at 265 (citations omitted).

71. Baylor v. Beverly Book Co., 216 Va. 22, 24, 216 S.E.2d 18, 19 (1975); White and P & W Oil Co. v. Perkins, 213 Va. 129, 135, 189 S.E.2d 315, 319 (1972). *See also* Wometco Enterprises Inc. v. Norfolk Coca-Cola Bottling Works, Inc., 528 F.2d 1128, 1129 (4th Cir. 1976), where the Fourth Circuit Court of Appeals, in construing section 13.1-94, held, *inter alia,* that the trial court properly applied a test of sharply scrutinizing the dealings between a corporation and its officers in a stockholders' derivative action alleging mismanagement of the corporation and seeking the appointment of a court-appointed custodian.

72. 213 Va. 129, 189 S.E. 2d 315 (1972).

who was owner of the remaining forty-five percent of the outstanding stock within the meaning of section 13.1-94(a)(2).[73]

However, the court overruled the remedy fashioned by the chancellor which did *not* order dissolution, but in lieu thereof, and among other things, disallowed the defendant's claim against the corporation of over $11,000.00 and ordered that plaintiff be paid $1,600.00, the equivalent of ten weeks' salary, as severance pay since his employment with the company had terminated. In ordering the outright dissolution of the corporation, the court offered the following explanation for its action:

> While Code § 13.1-94 is remedial and should be liberally construed, we believe that the 1968 amendment clearly shows an intent by the General Assembly that the alternatives provided there are *exclusive rather than inclusive.* Having so found, it follows that the trial court erred in granting the relief which it did.[74]

From the foregoing it appears that dissolution suits brought by minority stockholders which fall within and meet any of the four criteria listed in section 13.1-94(a)(1)-(4) will receive liberal, if not favorable, consideration from the courts in Virginia.

Not only can stockholders file suit to seek a judicial liquidation of the assets and business of a corporation under section 13.1-94, but creditors may also file suit under section 13.1-94(b) to liquidate the assets and business of a corporation when it is established initially that the corporation is insolvent[75] and that the claim of the creditor

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73. The court defined the meaning of the word "oppressive" found in section 13.1-94(a)(2) as follows:

> Oppression as a ground for corporate dissolution would appear to be of fairly recent origin. The statutory recognition of this ground first occurred in Illinois in 1933. *Central Life Ins. Co. v. Davis,* 10 Ill. 2d 566, 572, 141 N.E.2d 45, 49 (1957). By 1965 at least eleven other states, including Virginia, had adopted similar statutes. See 1965 Duke L.J. 128.
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> The word "oppressive," as used in the statute does not carry an essential inference of imminent disaster; it can contemplate a continuing course of conduct. The word does not necessarily savor of fraud, and the absence of "mismanagement, or misapplication of assets," does not prevent a finding that the conduct of the dominant directors or officers has been oppressive. It is not synonymous with "illegal" and "fraudulent."

213 Va. at 134, 189 S.E.2d at 319.

74. *Id.* at 135, 189 S.E.2d at 320 (emphasis added).

75. The word "insolvent" was defined by the Virginia Supreme Court in Martin v. South Salem Land Co., 94 Va. 28, 26 S.E. 591 (1896) in two contexts:

has been reduced to judgment and an execution thereon has returned unsatisfied[76] or the corporation has admitted in writing that the claim of the creditor is due and owing.[77] From the standpoint of creditors, the overriding consideration is how to obtain dollar-for-dollar value for the money, goods, or services supplied to the corporation. In order to aid creditors in their quest to recover the value of what was lent to the insolvent corporation, the concept of equitable liens, or, as it is more commonly called, the *trust fund* doctrine, has evolved. The Supreme Court of Virginia in *People's National Bank v. Morris,*[78] explained the trust fund doctrine as follows:

> The authorities seem to be uniform to the effect that the assets of the corporation are subject to an equitable lien in favor of the creditors, and that such creditors may follow such assets or the proceeds thereof, into whosesoever hands they can trace them and subject them to such debts, except as against a *bona fide* purchaser for value. And where a corporation transfers all its assets to another corporation with a view of going out of business, and nothing is left with which to pay its debts, such transferee is charged with notice by the very circumstance of the transaction, and takes the same *cum onere.* Such a case cannot be considered a sale in the due course of business, even though based on a valuable consideration, as it operates as a fraud against the creditors.[79]

The parameters of the trust fund doctrine described above as applied in Virginia have been stated in the following terms:

> [T]he strict view of the "trust fund" doctrine has not been adopted. In Virginia the trust fund doctrine prevails only to the extent that in the distribution of the corporate assets a court of equity will satisfy the claims of the creditors before any distribution can be made among

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> [I]n its restricted sense, to indicate the inability of an individual to pay his debts as they become due in the ordinary course of business, or in its general or popular meaning, to denote that the entire assets of a debtor are insufficient to pay his debts.

Id. at 52, 26 S.E. at 598. This concept of insolvency was applied in Gudebrod v. Ward's Adm'r, 165 Va. 444, 182 S.E. 118 (1935) to find a corporation insolvent when it was established in the lower court that the corporation had accumulated more than $575,000 worth of liabilities in thirteen years of operation and had total assets estimated between $150,000 to $525,000.

76. VA. CODE ANN. § 13.1-94(b)(1) (Repl. Vol. 1973).

77. VA. CODE ANN. § 13.1-94(b)(2) (Repl. Vol. 1973).

78. 152 Va. 814, 148 S.E. 828 (1929).

79. *Id.* at 820, 148 S.E. at 829.

> the stockholders. Within the meaning of this rule, unpaid subscriptions to the corporate stock constitute a part of the corporate assets, and in this sense of the "trust fund" doctrine constitutes a trust fund for the payment of creditors.[80]

How much of the creditor's claim can be satisfied from corporate assets and what liability stockholders incur if capital is distributed to them before creditor claims have been satisfied was addressed by the Virginia Supreme Court in *Marshall v. Fredericksburg Lumber Company.*[81]

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80. 4B MICHIE'S JUR. *Corporations* § 269 (Repl. Vol. 1974). For a discussion of the rights and priorities of creditors *inter se* to the assets of an insolvent corporation to liquidate outstanding debts see 4B MICHIE'S JUR. *Corporations* § 270 (Repl. Vol. 1974). It would appear that in Virginia unpaid stock subscriptions can be used to satisfy creditor claims even if the initial subscription contract between the corporation and the stockholder was procured through fraud unless the stockholder makes a sincere attempt to detect the fraud and to rescind the contract immediately once fraud is discovered. As was noted by the Virginia Supreme Court in Martin v. South Salem Land Company, 94 Va. 28, 26 S.E. 591 (1896):

> The decisions of the courts, we think, sustain the doctrine laid down in the textbooks that a person who has to all external appearances become a stockholder, cannot, as to creditors who may have trusted the company upon the faith of his membership, have his contract of subscription rescinded upon the ground of fraud where he did not repudiate the contract, and take steps to have it rescinded, before the company stopped payment and became actually insolvent; certainly not, where it does not appear that he was diligent in discovering the fraud and prompt in repudiating his contract after it was discovered.

Id. at 51, 26 S.E. at 598.

81. 162 Va. 136, 173 S.E. 553 (1934).

The court posited its arguments and reasons therefor as follows:

> Shares of stock in a corporation, before its dissolution, represent the proportion to which the shareholder is entitled in the distribution of profits arising from the operation of the business which may be made from time to time, and in the final distribution of the estate of the corporation when it ceases to exist and the estate has been fully administered, including the payment of corporate indebtedness. . . . A stockholder's rights are deferred to those of a creditor in the distribution of assets. *The creditors are entitled to the full payment of their debts before the stockholder participates therein.*
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> . . . .
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> . . . where there are existing creditors of a corporation the stockholders will not be permitted, as against those creditors, to withdraw the assets of the corporation without consideration, whether it be done through a purchase of stock by the corporation or otherwise. We repeat that a stockholder is not entitled to a share of the capital assets of a corporation until the debts have been paid. If the capital is divided, leaving any debts unpaid, *every stockholder receiving his share, is in equity liable pro rata to contribute to the discharge of such debts out of the funds so received.* Such property must be devoted, primarily, to the satisfaction of creditors and is subject to their rights; secondarily, to the stockholders, in proportion to their interests. As to it the creditors have a prior exclusive equity. In other words stockholders have no right to

From this case, it would appear that once a creditor or a group of creditors meet the criteria established in section 13.1-94(b)(1) or (b)(2) for the liquidation of corporate assets to satisfy their claims, said claims must be paid *in full* before the stockholders divide the remaining assets on a *pro rata* basis even if it means requiring the stockholders to pay any outstanding stock subscriptions for the benefit of creditors. If the assets of the insolvent corporation, including all stock subscriptions, are insufficient to pay the claims of creditors in full, the creditors will share the existing assets according to their respective rights and interests. In the situation just described or in the case where the assets of an insolvent corporation are barely sufficient to satisfy creditor claims, the stockholders would receive nothing. In the event, however, that corporate assets sufficiently liquidate creditor claims and there are remaining assets, Virginia courts should look to any stock agreements between the shareholders and should strictly interpret them regardless of any apparent inequities these agreements may cause. As observed by the Virginia Supreme Court in *Craddock-Terry Company v. Powell:*[82]

> "The rights (in a Massachusetts charter) thereby established with respect to the stockholders as between each other and between the stockholders and the corporation are contractual. *** Agreements voluntarily made between such persons are to be held sacred and enforced by the courts, and are not to be lightly set aside on the ground of public policy or because as events have turned it may be unfortunate for one party."
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> ". . . a stipulation plainly made between the stockholders, or classes of stockholders, as to how the assets of the corporation shall be distributed among the stockholders in liquidation, after all claims upon the corporation by creditors and others have been satisfied, is permissible and valid and is not forbidden by the principles of our corporation law."[83]

While the discussion of section 13.1-94 thus far has focused upon stockholder suits or creditor suits under subsections (a) or (b) respectively, the corporation, the board of directors of the corporation,

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anything but the residuum of the capital after the payment of all corporate liabilities. *Id.* at 146-47, 173 S.E. at 557 (emphasis added).

82. 181 Va. 417, 25 S.E.2d 363 (1943).

83. *Id.* at 447-48, 25 S.E.2d 376 (citations omitted).

or the Commission may, under certain circumstances described below, request the court to supervise or to direct the liquidation of the assets and business of a corporation. Under section 13.1-94(c), for example, upon the application of a corporation which has filed a statement of intent to dissolve, the liquidation of the corporation may be continued under the supervision of the court.[84] Moreover, under section 13.1-94(d) when the board of directors establish that circumstances make it impossible to obtain a representative vote by shareholders on the issue of dissolution *and* that to continue the business of the corporation would not be in the interest of the shareholders, the board may request the court to liquidate the assets and business of the corporation. The situation mentioned above is analogous to a stockholder suit under section 13.1-94(a)(1) and the principles and current legal trends described with regard to shareholder suits under section 13.1-94(a) should be applied in similar actions brought by the board of directors. Finally, pursuant to section 13.1-94(e), "[w]hen the Commission has instituted a proceeding for the involuntary dissolution of a corporation and entered an order finding that the corporation should be dissolved but that liquidation of its business and affairs should precede the entry of an order of dissolution"[85] the liquidation will be conducted under court supervision.[86]

In order to effectuate the liquidation of the assets and business of a corporation under section 13.1-94, the court of equity is vested with certain powers which are outlined in section 13.1-95 which provides in relevant part:

> [T]he court shall have power to issue injunctions, to appoint a receiver or receivers pendente lite, with such powers and duties as the court, from time to time, may direct, and to take such other proceedings as may be requisite to preserve the corporate assets wherever situated, and carry on the business of the corporation until a full hearing can be had.[87]

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84. *See also* VA. CODE ANN. § 13.1-84(c)(Repl. Vol. 1973).

85. VA. CODE ANN. § 13.1-94(e)(Repl. Vol. 1973).

86. It should be noted that in any proceeding brought under section 13.1-94, the statute further provides: "It shall not be necessary to make directors or stockholders parties to any such action or proceeding unless relief is sought against them personally." VA. CODE ANN. § 13.1-94 (Repl. Vol. 1973).

87. VA. CODE ANN. § 13.1-95 (Cum. Supp. 1977).

The powers and duties of the receivers[88] cited above are more clearly defined in the second full paragraph of section 13.1-95. For instance, a liquidating receiver has the authority "to collect the assets of the corporation, including all amounts owing to the corporation by subscribers on account of any unpaid portion of the consideration for the issuance of shares."[89] In addition, the receiver, if authorized by the court, can "sell, convey, and dispose of all or any part of the assets of the corporation wherever situated, either at public or private sale."[90]

Once the affairs of the corporation have been properly taken care of by the receiver, the Commission, or the directors of the corporation,[91] and the court has issued an appropriate order or the Commission has issued a certificate of dissolution pursuant to section 13.1-90, the nonexistence of the corporation does not preclude further action relating to its prior activities before dissolution or expiration as stated in the topical heading described below.

IV. Survival of Remedy After Dissolution

Section 13.1-101 permits a corporation, its directors, officers, or stockholders to sue or be sued after dissolution or expiration of the corporation and provides in pertinent part: "The dissolution or expiration of a corporation shall not take away or impair any remedy available to or against such corporation, its directors, officers or stockholders, for any right or claim existing or any liability incurred, prior to such dissolution."[92] The instant statute is a complete departure from the common law rule under which the dissolution of a corporation meant its existence terminated immediately and

88. The qualifications required to be a receiver are stated in VA CODE ANN. § 13.1-96 (Rep. Vol. 1973).

89. VA. CODE ANN. § 13.1-95 (Cum. Supp. 1977).

90. *Id.*

91. It is of importance to note that section 13.1-98 states in full:

> The liquidation of the assets and business of a corporation may be discontinued at any time during the liquidation proceedings when it is established that cause for liquidation no longer exists. In such event the court shall dismiss the proceedings and direct the receiver to redeliver to the corporation all its remaining property and assets.

VA. CODE ANN. § 13.1-98 (Repl. Vol. 1973).

92. VA. CODE ANN. § 13.1-101 (Repl. Vol. 1973).

thereby extinguished corporate debts or debts owed to the corporation; the common law rule for all intents and purposes precluded suits on behalf of or against a corporation after dissolution.[93] Stat-

93. An early Virginia case, Rider v. Nelson and Albemarle Union Factory, 34 Va. (7 Leigh) 154 (1836), explained the common law rule and lamented legislative inaction to ameliorate the abuses therefrom, as follows:

> It may be proper to add, that it appears to us to be peculiarly desirable, in a country where numerous companies are annually incorporated for a limited number of years, that the legislature should provide in detail, what shall be the effect of the expiration or other determination of their charters, instead of leaving that matter to the embarrassment and the obscurity of common law principles. According to them, the debts of a corporation either to it or from it are extinguished by its dissolution; nor are the members liable, in their individual characters, for any portion of the debts of the corporation; 1 Lev. 237. The lands of the corporation revert to the donors; 1 Black. Comm. 484. The personality, it is supposed, goes to the commonwealth. If these things be so (and there is no reasonable doubt about it) they are grossly unjust. It cannot be just, that the members of a joint stock company should forfeit their property to the commonwealth by the expiration of their charter. It cannot be just, that the land which they have purchased and paid for, should revert to the grantor who has already received value for it. It cannot be just, that those who are indebted to the corporation (a bank for instance) should be absolved from their engagements; and still less, that by a forfeiture of its charter, those to whom it is indebted should lose their just demands.

Id. at 156-57.

The West Virginia Supreme Court, in Miller's Adm'x v. Newburg Orrel Coal Co., 31 W.Va. 836, 8 S.E. 600 (1888), described the General Assembly of Virginia's response to the *Rider* decision:

> Very soon after *Rider v. Factory, supra,* was decided, and, according to a suggestion of the court in that case, the general assembly of Virginia, at its session of 1836-37, passed an act, which has ever since been in force. This statute, without material change, was incorporated in our Code of 1868, and has continued to be, and still is, in force in this State. It provides . . . that . . . 'suits may be brought, continued, or defended; the property, real or personal, of the corporation be conveyed or transferred, under the common seal or otherwise; and all lawful acts be done, in the corporate name, in like manner, and with like effect, as before such dissolution or expiration; but so far only as shall be necessary or proper for collecting the debts and claims due to the corporation, converting its property and assets into money, prosecuting and protecting its rights, enforcing its liabilities, and paying over and distributing its property and assets, or the proceeds thereof, to those entitled thereto . . . .'

Id. at 838-39, 8 S.E. at 601-02.

The court offered this interpretation of the statute:

> It provides in general terms, that suits may be brought or defended in the corporate name with like effect as before the dissolution, so far as shall be necessary for collecting the debts and enforcing the liabilities of the corporation. This language is certainly sufficiently comprehensive to embrace any suit, whether in law or in equity, which may be proper for collecting the debts due to, or enforcing the liabilities against, the corporation; and this seems also to give effect to the general object and purpose of the statute.

Id. at 839, 8 S.E. at 602.

utes enacted to prevent the abuses described in *Rider v. The Nelson and Albemarle Union Factory*[94] provided for suits to be instituted against or on behalf of a corporation within three years following dissolution.[95] In 1956, however, the General Assembly made substantial revisions in the Corporation Code which produced section 13.1-101 in its current form. An excellent analysis comparing the former code section,[96] which permitted suits to be instituted by or against a corporation within a three-year period, with section 13.1-101 is found in *United States v. Village Corporation.*[97] The court explained:

> Under old Title 13, corporate existence was continued after dissolution, for the purposes of liquidation, for a period of three years, and during that period actions could be instituted by or against it in its corporate name. Dissolution did not abate pending actions. The directors, as trustees, were required to proceed with the liquidation of the corporation. Upon application of a creditor or stockholder, an appropriate court of Virginia was authorized to continue the authority of the directors as trustees or to appoint a receiver, the trustees or the receiver being authorized, in the name of the corporation, to defend the suit brought by the applying creditor or stockholder.
>
> For this somewhat cumbersome procedure, new Title 13.1 substituted a simplified remedy. It authorized actions by or against the corporation, and in its corporate name, after dissolution without a limitation of time. Under the new statute, passage of time after the date of dissolution is without significance. A court order continuing the authority of directors or appointing a receiver is no longer a prerequisite to the institution of an action against a corporation in dissolution at any time.[98]

It should be observed that in a footnote immediately following the statement quoted above, that "passage of time after the date of dissolution is without significance," the court qualified its pronouncement by cautioning: "Of course, general statutes of limita-

94. 34 Va. (7 Leigh) 154 (1836). *See* note 93 *supra.*

95. See former § 3810 of the Code of Virginia as discussed in Shepherd v. F.J. Kress Box Co., 154 Va. 421, 426, 153 S.E. 649, 650 (1930).

96. VA. CODE ANN. § 13-70 repealed 1956 VA. ACTS ch. 428.

97. 298 F.2d 816 (4th Cir. 1962).

98. *Id.* at 817-18.

tion referable to the accrual of the cuase of action remain applicable."[99] Moreover, "[s]tatutes of this type are remedial and should be broadly and liberally construed. Obviously it would be intolerable and contrary to public policy to permit a corporation to evade civil liability or to escape criminal penalties by voluntarily terminating its existence."[100]

An issue which could arise under section 13.1-101, which, to date, has not developed, is what is the liability of a corporation which succeeds to the assets of another for the debts of the selling corporation. This problem would ordinarily manifest itself in the context of a merger and was addressed by the Virginia Supreme Court in *Pepper v. Dixie Splint Coal Co.*,[101] which posited four criteria, any one of which would be sufficient to render the purchasing company liable for the debts of the selling corporation when it appears:

> (a) there [is] an agreement to assume such debt; (b) the circumstances surrounding the transaction must warrant a finding that there was a consolidation of the two corporations; or (c) that the purchasing corporation was a mere continuation of the selling corporation; or (d) that the transaction was fraudulent in fact.[102]

In applying the above-mentioned criteria the court should carefully scrutunize the activities of the two corporations and should construe section 13.1-101 broadly, especially where the rights of creditors are jeopardized.

V. LEGISLATIVE REFORM

A thorough review of Article 7 of the Corporation Code indicates that particular provisions should be combined, amended, or deleted entirely to provide a more equitable and understandable code for the dissolution of corporations. At this point certain suggestions are offered which the General Assembly will hopefully consider, or, at the very least, will prompt interested legislators to review Article 7 with a view toward enacting amendments or repealing obsolete and

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99. *Id.* at 818 n. 10. *See generally,* VA. CODE ANN. §§ 8.01-228 to -256 (Repl. Vol. 1977).

100. United States v. Maryland & Va. Milk Producers, 145 F. Supp. 374, 375 (D. Md. 1956) which found a corporate defendant in violation of the Robinson-Patman Act.

101. 165 Va. 179, 181 S.E. 406 (1935).

102. *Id.* at 191, 181 S.E. at 410 (citations omitted).

redundant sections to aid the corporation, its officers, directors, shareholders, and the general public.

One necessary change should be the total elimination of section 13.1-80 (the voluntary dissolution of a corporation provision by the written consent of *all* stockholders).[103] It is submitted that in the overwhelming number of situations this provision will never be used; large corporations have too many stockholders to obtain the required unanimity and small or closely-held corporations are too often divided among various factions (especially in closed corporations where family disputes concerning the proper operation of the business frequently develop) with irreconcilable differences which makes total agreement on anything impossible to achieve. Moreover, requiring the unanimous vote of *all* stockholders to secure a voluntary dissolution appears at odds with section 13.1-81 which requires in comparison an affirmative vote of more than two-thirds of the shares entitled to vote or upon the resolution affirmatively adopted by the holders of more than two-thirds of the shares of any class of stock entitled to vote on the question of dissolution. If two-thirds of the holders of any class of stock entitled to vote on the question of dissolution is enough to subject a corporation to voluntary dissolution proceedings, why is it necessary to mandate under section 13.1-80 the *unanimous* vote of stockholders on the same issue? In reality section 13.1-80 is at best repetitious and at worst confusing when compared with section 13.1-81. Accordingly, whenever more than two-thirds of the stockholders or more than two-thirds of the shares of stock entitled to vote do, in fact, vote for voluntary dissolution, their preference should be honored by the Commission if the formal requirements for dissolution are subsequently met.[104]

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103. Total elimination of this provision would also require the complete repeal of section 13.1-85 which provides for the revocation of voluntary dissolution proceedings by consent of all stockholders. Clearly, if section 13.1-80 is eliminated, the need for section 13.1-85 likewise ceases to exist.

104. By way of further suggestion, section 13.1-81 (a) should be amended to include, in addition to a resolution adopted by the board of directors, an alternative section calling for a resolution adopted by a significant number of shares entitled to vote on the issue of dissolution, such as 20%, 25%, or 33%, to force a meeting to decide the question of whether the corporation should voluntarily dissolve. A provision of this sort might be necessary since an indifferent or insensitive board of directors may never adopt a resolution seeking voluntary dissolution despite a large number of stockholders or representative shares which feel otherwise.

The second and last full paragraph of section 13.1-82, in response to *Jeffries v. Commonwealth,*[105] requires the Commission to carefully review a statement of intent to dissolve filed by a public service corporation before said statement is approved to determine whether the corporation is actually performing any public service, whether the corporation should be required to continue to perform any public service, or whether the public convenience and necessity mandate the continuation of the public service performed by the corporation. Beyond the criteria stated above, there is no mention in the statute of how or in what manner the Commission should make its determination.

Public service corporations, which provide such vital services as gas, electricity, water, and transportation should be given the opportunity to state their case for dissolution and should not be confined to a cursory statement of intent to dissolve which is all they are obliged to file under section 13.1-80 or section 13.1-81. In addition, affected customers, consumer groups, and the like should also have a forum to present their views on the voluntary dissolution of the corporation. Given these considerations and the trend in many jurisdictions to permit the public to participate in legislative or quasi-legislative proceedings under so-called "sunshine laws", provision should be made within section 13.1-82 for the holding of public hearings in the locality where the service would be curtailed or eliminated via dissolution to permit, first of all, interested parties to present their opinions, but more importantly, to insure that the Commission has sufficient information to make an informed and intelligent decision concerning matters of great private and public interest. Only in this way can all parties be assured that they had a fair opportunity to present their case and that the decision of the Commission was made with full knowledge of all relevant factors.

Section 13.1-83 provides, *inter alia,* that once a corporation files a statement of intent to dissolve, it "shall cease to carry on its business, except insofar as may be necessary for the winding up thereof."[106] Section 13.1-84(b) describes a laundry-list of duties a corporation must perform after its statment of intent to dissolve is

105. 121 Va. 425, 93 S.E. 701 (1917). See note 20 *supra,* and accompanying text.
106. VA. CODE ANN. § 13.1-83 (Repl. Vol. 1973).

filed. Although the items outlined in section 13.1-84(b) appear to be in the nature of winding up the affairs of a corporation, nothing is stated in either of the two statutes under discussion which *specifically indicates* what constitutes winding up the business and affairs of a corporation; accordingly, either section 13.1-83 or section 13.1-84 should state without equivocation what constitutes winding up within the meaning of the statute. Furthermore, and of critical importance, section 13.1-83 or section 13.1-84 should be amended to provide for criminal sanctions[107] in the event the corporation or its trustees continue to operate the business as a going concern contrary to its statement of intent to dissolve. Criminal sanctions should deter corporate officials from going beyond the scope of winding up the affairs of a corporation and thereby prevent conduct which would be detrimental to third parties (creditors and employees alike).

The suggestion described above should also be incorporated into the automatic and involuntary dissolution provisions of the Code which likewise provide for the winding up of the affairs of a corporation by the directors, who, by operation of law, become trustees of the corporation. Although such criminal sanctions may appear harsh even if made a misdemeanor with a minor monetary penalty and/or imprisonment, it must be borne in mind that the ability of individuals to avail themselves of the corporate form and thereby limit their personal liability is a right created by the state and should not be abused by persons who would hold themselves out to the world as representing a non-existent principal, *i.e.*, the corporation, when in fact they are a sole proprietorship or a partnership. Such actions are generally a willful and conscious concealment of a material fact and tantamount to fraud upon the "corporation's" customers, creditors, and employees, and serves to undermine the free enterprise system; in short, continuing the business of a corporation instead of winding it up pursuant to definite statutory guide-

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107. *See, e.g.*, Mo. ANN. STAT. § 351.530 (Vernon 1966), which states in its entirety:

> Any person, or persons, who shall exercise, or attempt to exercise, any of the powers, privileges, or franchises of any corporation after the certificate of incorporation or of the authority of the same has been forfeited and canceled as in this chapter provided shall be deemed guilty of a misdemeanor, and upon conviction punished as herein provided.

lines works to everyone's detriment and should not go unpunished by the state.

Finally, section 13.1-91, which provides for automatic dissolution of a corporation if it fails to file on two successive annual dates its annual report or to pay its annual registration fee or franchise tax as required by law, should be combined with section 13.1-93 to form one automatic or involuntary dissolution statute. It is difficult to find any substantive or quantitative harm to the state in a corporation's failure to perform the obligations described above as compared with a finding by the Commission that the corporation has continued to exceed or abuse the authority conferred upon it by law, has failed to maintain a registered office or a registered agent within the state, or has failed to comply with any act required by the Commission pursuant to section 13.1-93.[108] All of the requirements mentioned above, while serving the public interest, nevertheless are essentially clerical in nature (with the possible exception of exceeding or abusing the authority to conduct a business as specified in a corporation's charter), and the right to official notice of impending dissolution and the opportunity to be heard on the issue, as provided in section 13.1-93, should be provided for *all* corporate failures to meet the clerical obligations in question. In this way the corporation can explain its actions or inactions and fulfill any derelict responsibilities before its charter is automatically or involuntarily forfeited by the state. This procedure, although on its face an apparent drain on the resources of the Commission, might prevent prospective failures to perform the administrative duties under discussion and, if the corporation agrees to live up to its responsibilities, the need of the corporation to proceed with any reinstatement procedures would also be eliminated thereby saving the Commission work in the long run. With regard to reinstatement, since section 13.1-93 has its own reinstatement provision which is identical with the separate reinstatement provision found in section 13.1-92, which applies exclusively to automatic dissolution, combining sections 13.1-91 and 13.1-93 into one statute would eliminate the need to have a separate reinstatment provision and would require the repeal of section 13.1-92.

108. *See* VA. CODE ANN. § 13.1-93 (Cum. Supp. 1977).

In conclusion, it is the author's desire that the explanation of the mechanics of Article 7, the analysis of the current status and trends in Virginia case law involving the major issues discussed herein, and the suggested improvements for Article 7 through legislative reform, have provided the Virginia legal community, and the various interests represented by that community, with a better understanding of their rights, obligations, and limitations so that ultimately any inequities inherent in dissolving a corporation which seriously affects any interest, will be resolved, either legislatively, administratively, or judicially, for the betterment of all parties concerned.

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